BERK
PHONE 206.324.8760
2025 First Avenue, Suite 800
Seattle, WA 98121
www.berkconsulting.com

MEMORANDUM

DATE: October 9, 2012

TO: Council Members, City of Issaquah; Mark Hinthorne, Planning Director, City of Issaquah

FROM: Morgan Shook and Erik Rundell, BERK

RE: DISCUSSION DRAFT City of Issaquah Fiscal Evaluation and Infrastructure Funding for the Central Issaquah Subarea – Potential Investment Options

PURPOSE

The following assessment discusses the use of a select number of investment tools that the City of Issaquah may choose to use in support of their vision of in the Central Issaquah Subarea.

- Multifamily Property Tax Exemption (MFTE)
- Transportation Benefit District (TBD)
- Landscape Conservation and Local Financing Tool (LCLIP)

This list of investment options is meant to provide the City with a basis for understanding the types of choices that the City could pursue. It is by no means exhaustive; the selected measures are addressed here given previous interest by the City. Future work will involve investigating

The revenue estimates cited here represent potential investment costs and funding amounts tied to growth assumption in the Central Issaquah Subarea Plan. **These estimates should not be confused with projecting the amount of financing that might be available** if those choices are put forward. The exercise here contemplates the relative magnitude (in most cases, maximum magnitude) of the policy choice if the City were to move forward with the policy.

1.0 MULTI-FAMILY PROPERTY TAX EXEMPTION

Under RCW 84.14, Washington cities with a population of 15,000 or more may establish a tax exemption program to stimulate the construction of new, rehabilitated, or converted multi-family housing within designated areas of the cities, including affordable housing. The intent of the legislation is "to stimulate new or enhanced residential opportunities within urban centers through a tax incentive." This program is commonly referred to as the MFTE.

The exemption targets new, rehabilitated, or converted multi-dwelling housing projects for an 8-year property tax abatement. The exemption applies only to eligible cities that choose to participate. Under the old law only cities with a population of at least 15,000, or the largest city or town in the county planning under GMA, may have offered the property tax exemption. The property tax exemption may only be applied to the residential portion of the value of the new construction and to the increased value of a rehabilitated building. The exemption does not cover the underlying value of the land or non-housing improvements. There is a variety of other programmatic requirements projects must meet in order to gain the exemption.

The legislature added an affordable housing option for developers/owners willing to commit at least 20% of the units to meeting affordable housing needs at the low and moderate income level in 2007. Projects that meet this affordable housing criterion are eligible for a 12 year abatement period, 50% (four years) longer than the standard abatement period.

Consistent with the intent of the law, cities have generally implemented the property tax abatement as an incentive to lower the near-term risk of residential multifamily projects often associated with housing or redevelopment goals. To understand the potential fiscal implications to the City of the multi-unit residential tax abatement, it is necessary to understand how the project will impact the assessed value base of the City and how this translates to impacts on the City's property tax levy.

The practical impact of offering the property tax abatement is twofold: 1) the residential portion of the project is classified tax exempt for the period of the abatement; and 2) the value of the new residential construction is added to the City's property tax base at the end of the abatement period rather than in the year of project completion. The effect is that the property tax benefit associated with residential new construction is deferred until the end of the exemption period.

1.1 Summary of Findings

The use of the MFTE (or almost all property tax exemptions) is technically a "tax expenditure", or spending through the tax code. Here, the expenditure is the delayed revenue that City would receive if the new construction add-on value to the City's current expense levy is delayed by the use of the MFTE on eligible projects.

Key Assumptions

- For this assessment, the MFTE is applied to all multifamily projects at each assumed level of development for the alternatives.
- All projects are assumed to participate at the 12 year exemption level meaning they would agree to dedicate a portion of housing units targeted at affordable levels.

Findings

The use of the MFTE in the area will reduce the amount of property tax revenues generated within the subarea for all three alternatives. The 30-year present value of property taxes represents the impact of 1) delaying the current expense levy increase tied to new construction; and 2) applying the 12-year exemption to the projects.

Exhibit 1: Reduction in Property Tax from MFTE

	Housing Units		District Property Tax Revenue		
	Total	Exempt	w/o MFTE	w/ MFTE	Tax Expenditure
No Action	2,000	2,000	$24,900,000	$20,500,000	$4,400,000
Task Force	2,900	2,900	$39,900,000	$33,600,000	$6,300,000
Growth Center	7,750	7,750	$45,900,000	$29,000,000	$16,900,000

Source: BERK, 2012. Note: All figures in 2012 dollars.

2.0 TRANSPORTATION BENEFIT DISTRICT

TBDs are quasi-municipal corporations and independent taxing districts formed solely for the purpose of acquiring, constructing, improving, providing, and funding transportation improvements within the district's boundaries. RCW 36.73 provides the authority for cities or counties to form TBDs and may include other cities, counties, port districts, or transit districts through interlocal agreements. There is flexibility in establishing the boundaries of the TBD, which may only include a portion of the City. However, certain revenues require that the TBD must be city- or county-wide.

In order to establish a TBD, the City must create a TBD ordinance which would include findings of public's interest in the formation of a TBD, boundaries of the TBD, description of improvements, and proposed taxes. The City is required to hold a public hearing to present TBD ordinance and allow public input. Following the hearing, the City may establish the TBD.

2.1 TBD Project Threshold Tests and Acceptable Transportation Projects

In general, there are three threshold tests to determine if a particular transportation improvement can be funded through a TBD:

- The improvement must be within the boundaries of the TBD;
- The improvement must be identified in an existing state, regional, county, city, or eligible TBD jurisdiction's (port or transit) transportation plan; and
- The improvement is necessitated by existing or foreseeable congestion levels. The definition of an improvement project is broad and can include the investment in new or existing highways of statewide significance, principal arterials of regional significance, high capacity transportation, public transportation, and other transportation projects and programs of regional or statewide significance including transportation demand management. Projects may also include the operation, preservation, and maintenance of these facilities or programs.

2.2 Other TBD Requirements

The following provisions detail other TBD requirements:

- Revenue rates may not be increased unless authorized by voter approval.
- If project costs exceed original costs by more than 20%, a public hearing must be held to gather public comment regarding how the cost change should be resolved.
- A TBD annual report detailing project costs, status, revenues, expenditures, and construction schedules.
- TBD must be dissolved upon completion of the cited project(s) in the adopted ordinance and the payment of debt service.

2.3 TBD Revenue and Boundary Options

There are several options TBDs have to generate revenues to support transportation improvement projects. Some revenues have restrictions, such as requiring voter approval and some have to be applied citywide. The TBD revenue options and whether they require voter approval are listed below in Exhibit 2.

Exhibit 2: TBD Revenue Options

Revenue Options Not Subject to Voter Approval	Revenue Options Subject to Voter Approval
• **Citywide $20 vehicle license fee; and** • **Citywide impact fees placed on new development.**	• Citywide vehicle license fees above $20 and up maximum of $100. Boundaries of TBD must be citywide; • Up to 0.2% sales and use tax; • One-year excess property tax levy or an excess levy for capital purposes; and • Vehicle tolls.

Source: BERK 2011, RCW 76.63

2.4 Summary of Findings

Key Assumptions

The analysis assessed one revenue option and two alternative TBD boundaries. The revenue options include a voter-approved 0.2% Sales Tax. The revenue impact of the 0.2% sales tax was estimated for TBD covering both the City and Central Issaquah Subarea.

Findings

The use of TBD, whether on a subarea or City basis has the ability to generate significant revenues across all alternatives. Assuming full buildout and a 20-year present value (at 3% discount rate), the commercial orientation of the Task Force alternative produces the most funding.

Exhibit 3: Revenue from TBD

	Transportation Benefit District	
	Central Issaquah	City-wide
No Action	$29,500,000	$46,900,000
Task Force	$35,200,000	$52,700,000
Growth Center	$31,500,000	$49,000,000

Source: BERK, 2012. Note: All figures in 2012 dollars.

As a point of context - based on 2012 taxable retail sales data for the City of Issaquah, a 0.2% sales tax TBD for the Central Issaquah Subarea would have generated roughly $1.3 million in funding. Extended to the entire City, it would have generated roughly $2.3 million.

3.0 LCLIP PROGRAM DESCRIPTION

3.1 Definition

LCLIP is a form of tax increment financing enacted in 2011. The Washington State legislature created the LCLIP program based on its finding that:

> *The state and its residents benefit from investment in public infrastructure that is associated with urban growth facilitated by the transfer of development from agricultural and forest lands of long-term commercial significance. These activities advance multiple state growth management goals and*

benefit the state and local economies. It is in the public interest to enable local governments to finance such infrastructure investments and to incentivize development right transfer in the central Puget Sound through this chapter.

The program offers the use of tax increment financing to a city in return for: 1) the creation of a TDR program; and, 2) the acceptance of a specified amount regional development rights. In exchange for the placement of rural development rights in LCLIP districts, the jurisdictional county agrees to contribute a portion of its regular property tax to the sponsoring city for use for a defined period. The program is only available to select cities in the central Puget Sound counties of King, Pierce, and Snohomish.

The LCLIP program targets only a portion of the incremental property taxes generated from new development. The remaining portion of the property tax still accrues to the sponsoring city and to the jurisdictional county. Existing and incremental revenues flowing from sales, business and occupation, and utility taxes still accrue to the city, as well as, other capital restricted revenues.

3.2 Key LCLIP Program Features

District Revenue Allocations

The value of new construction in an LCLIP district serves as the basis for the revenue calculation. The value of a building is a function of size and value per unit. Holding the scale of a building constant, the value of the building generally reflects the present value of the building's projected future net income. A key consideration in sizing the LCLIP district(s) is that the cumulative amount of assessed real property in LCLIP districts must not exceed 25% of the city's total assessed value.

LCLIP revenues are derived by allocating a portion of the city's regular property tax (e.g. current expense levy) to the LCLIP district. Once a district has been created by a city, 75% of the assessed value of new construction – multiplied by a city's Sponsoring Ratio – is allocated to the LCLIP district and used as the tax basis to distribute revenues from the regular property tax.

For example, suppose a newly constructed building generates $1,000 in regular property tax revenues on a property tax rate of $1.00. If this same building is valued at $1,000,000 for the purposes of new construction, then 75% (multiplied by the Sponsoring City Ratio, explained below) of the new construction would place $750,000 in the LCLIP assessed value base and lead to the distribution of $750 of the $1,000 paid in regular property tax to LCLIP area. The remaining $250 would still go to the city's general fund. As noted, the Sponsoring City Ratio acts to modulate how much of the 75% of new construction gets added to the LCLIP assessed value base. The example above assumes a ratio of 1.0. Alternatively, a ratio 0.25 would reduce that $750 revenue apportionment to $188.

The calculation of LCLIP assessed value basis starts at the time that the district(s) is created. The dedication of city and county property tax revenues to the District commence the second year after the District is established.

Sponsoring City Ratio

The Sponsoring City ratio reflects the proportion of development rights a city has chosen to accept related to the receiving city allocated share, as determined by PSRC. The resulting ratio of "specified portion" to "allocated share", anywhere from 0 to 1, acts to modulate the amount of new construction value that can accumulate to a LCLIP district. Accepting the full allocated share would maximize LCLIP revenues while taking something less than then full allocated share reduces the potential value of the program to the city. For example, if a city is allocated 500 rights (allocated share) but chooses only to accept 250 of them (specified portion), its resulting sponsoring city ratio is 0.5 (250 divided by 500).

Use of TDR

The number of TDR utilized is a function of several factors:

- **The size of the incentive zoning capacity increment.** The City must determine how much demand there may be in for building beyond the zoning capacity for which buyers may want to access.
- **The nature of the incentive associated with TDR.** Typical TDR incentives offer additional FAR or height; however, TDR can be connected with any variety of opportunities associated with development ("conversion commodities"). Other examples include connecting TDR with reduced setbacks, structured parking requirements, or impervious surface limitations.
- **The "exchange rate" for TDR.** The amount of incentive a developer receives per TDR credit utilized in large part determines whether or the extent to which TDR is used by developers. The incentive created by the TDR exchange rate must be equal to or exceed a developer's willingness to pay, otherwise TDR will not be used.
- **The structure of a TDR incentive.** A city can choose to either (1) fix the incentive received per TDR credit regardless of cost (e.g. 1500 s.f. per TDR credit) or (2) fix the incentive received scaled on TDR cost (e.g. $20 per square foot). Trade-offs exist; however, the structure pursued has implications on the number of TDR credits used in the city. For example, if developers receive 1500 s.f. per TDR credit and incentive zoning allows up to 15,000 additional square feet for TDR, a city is certain it has zoned capacity for 10 TDR credits. Conversely, if a city fixes the incentive at $20 per square foot and scales it to the price paid per TDR credit, a city is uncertain developers will use fewer or greater than 10 TDR credits to achieve the zoned capacity.

Timing – Credit Placement Thresholds

Cities using the LCLIP tool must meet a series of performance thresholds in regards to permitting or acquisition of development rights if they want to start and extend the program revenues. These thresholds are assumed as follows:

- Threshold #1: Placement of 25% of the specified portion is required to start the program.
- Threshold #2: Placement of 50% of the specified portion is required by year 10 to extend it 5 years.
- Threshold #3: Placement of 75% of the specified portion is required by year 15 to extend it 5 years.
- Threshold #4: Placement of 100% of the specified portion is required by year 20 to extend it 5 years to its conclusion.

3.3 Summary of Findings

Assumptions

For these scenarios, it is assumed that the City would start its LCLIP program in 2013 with only a Central Issaquah Subarea LCLIP district participating. Also, it is assumed that the City would fix its Sponsoring City Specified Ratio at 1.0 – meaning that it would agree to accept the full amount of its PSRC allocated share of 452 development rights.

Findings

The results of the scenarios as summarized in Exhibit 4 (Note: all figures in 2012 dollars; 25-year present value at 3% discount rate). All alternatives could generate substantial funding for infrastructure. Depending on alternative, LCLIP could generate anywhere from $25 to $41 million in funding. The Task Force alternative generates relatively more on due to the scale and value of construction contemplated within that alternative. In any of the alternatives, the City would have to allocate a portion of their incremental property taxes to the revenue. The "new" funding would come from the County in the "matching" amount of incremental property taxes. In the instances below, that leverage ratio is at 1.79 – in other words, for every $1.00 that the City contributes to LCLIP funding, the County would contribute an additional $0.79.

Exhibit 4: LCLIP Revenue Summary

	LCLIP Revenue		
	City Allocation	County Allocation	Total LCLIP
No Action	$14,000,000	$11,000,000	$25,000,000
Task Force	$23,000,000	$18,000,000	$41,000,000
Growth Center	$19,000,000	$15,000,000	$34,000,000

Source: BERK, 2012. Note: all figures in 2012 dollars; 25-year present value at 3% discount rate.